

REPORT BY THE
AUDITOR GENERAL
OF CALIFORNIA

THE DEPARTMENT OF HEALTH SERVICES
DID NOT COMPLY WITH ALL REQUIREMENTS
FOR AWARDING AND MANAGING CONSULTANT CONTRACTS

REPORT BY THE
OFFICE OF THE AUDITOR GENERAL

P-753

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October 19, 1988

P-753

Honorable Bruce Bronzan, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 448
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning the Department of Health Services' (DHS) compliance with the requirements of the Public Contract Code for awarding and managing consultant contracts. The report indicates that the DHS needs to obtain competitive bids for consultant contracts that do not meet the specific criteria for exemption and to ensure that it complies with other contracting requirements. It further indicates that the Department of General Services needs to ensure that the DHS is in compliance with the Public Contract Code before it approves the DHS' consultant contracts.

Respectfully submitted,

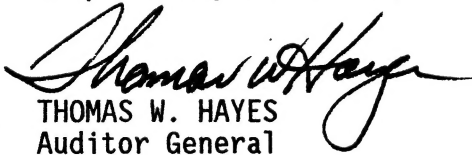

THOMAS W. HAYES
Auditor General

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SUMMARY

RESULTS IN BRIEF

The Department of Health Services (department) awarded and managed 105 consultant contracts between July 1, 1985, and December 31, 1987. During our examination of 46 of these consultant contracts, we noted the following specific deficiencies:

- The department awarded 19 consultant contracts, for over \$9 million, without obtaining at least three competitive bids or meeting the exemption requirements in the Public Contract Code;
- The department did not always comply with the requirement for submitting contractor post evaluations to the Department of General Services (DGS) upon the completion of a contract in 5 (16 percent) of 31 contracts in our sample, nor did it review any of the previous post evaluations for consultants on file with the DGS before awarding the 105 consultant contracts during our review period;
- Work was begun on 22 of the department's contracts before obtaining contract approval and failed to seek the DGS' approval for one contract and three amended contracts that exceeded the department's authority to exempt without the DGS' approval;
- The department does not ensure that current and former state employees are not receiving consultant contracts to which they are not legally entitled; and
- The department did not report 15 (14 percent) of 105 consultant contracts to the Legislature during our review period. In addition, for 10 (28 percent) of the 36 contracts for over \$5,000 that we reviewed, the department did not report the contract

awards to the Department of Fair Employment and Housing, as required by law..

BACKGROUND

The department maintains two contract management sections for the administration of the department's contracts, including those for consultant services. These two sections are responsible for reviewing and approving contracts for services and consultants. During fiscal year 1986-87, the two contract management sections processed more than 1,400 contracts with public and private entities for services to the department. The consultant contracts reported to the Legislature during this fiscal year accounted for 42 (3 percent) of the contracts processed by the department's contract management sections with a total contract amount of \$2.8 million.

PRINCIPAL FINDINGS

The Department of Health Services
Did Not Obtain Competitive Bids
for Consultant Contracts That
Did Not Meet the Criteria for Exemption

The department awarded 19 of the 46 consultant contracts in our review without obtaining three competitive bids, as required by the Public Contract Code, although the contracts did not meet the specific conditions for exemption from this requirement. Moreover, the DGS approved the department's requests for exemption from competitive bidding even though the contracts did not meet the criteria established in the State Administrative Manual. As a result, over \$9 million in consultant contracts were awarded without assurance that the department had complied with the law or that the contractors were the lowest responsible bidders meeting standards or the bidders whose proposals were given the highest scores by an evaluation committee.

The Department of Health Services Did Not
Comply With All Requirements for
Awarding and Managing Consultant Contracts

The department is responsible for ensuring that it complies with all required statutes, regulations, State Administrative Manual policies and procedures, and departmental policies and procedures for the award of contracts. We found, however, that the department did not comply with the following requirements:

- It did not submit 5 (16 percent) of 31 post evaluations of consultants once the contracts were completed and did not review the post evaluations for consultant contractors on file with the DGS before awarding consultant contracts during our review period;
- It did not receive approval before work had been started on 22 (48 percent) of the 46 consultant contracts that we reviewed and failed to seek the DGS' approval for one contract and three amended contracts that exceeded the department's authority to exempt without the DGS' approval;
- It does not ensure that current and former state employees are not receiving consultant contracts to which they are not legally entitled; and
- It did not comply with the requirement to report to the Department of Fair Employment and Housing the award of 10 (28 percent) of 36 consultant contracts that we reviewed, nor did it report to the Legislature 15 (14 percent) of the 105 consultant contracts awarded during our review period.

Because the department did not comply with these requirements, the department could not ensure that the contracts were awarded to the best qualified contractor, that the contracts were fairly awarded, or that the department complied with the law.

RECOMMENDATIONS

To comply with the provisions of the Public Contract Code, the department should take the following actions:

- Secure competitive bids for consultant contracts, or ensure that the justifications for exemption submitted to the DGS meet the criteria established in the Public Contract Code;
- Ensure that it submit evaluations of contractors within 30 days after the contract is completed, and review the evaluations of potential contractors before awarding contracts;
- Require its staff to initiate the processing of contracts early enough to ensure that the contracts are approved before their starting dates; and
- Ensure that current and former state employees are not receiving contract awards to which they are not legally entitled.

To ensure that all state agencies are in compliance with the provisions of the Public Contract Code, the DGS should take the following actions:

- Approve exemptions from competitive bidding requirements for consultant contracts only when state agencies clearly demonstrate that contracts meet the criteria of the Public Contract Code, and this demonstration should include an extensive survey of potential vendors; and
- Enforce the requirements of the Public Contract Code for reviewing and submitting the post evaluations of consultant contractors.

AGENCY COMMENTS

The Department of Health Services generally agrees with the Office of the Auditor General's recommendations. However, the department believes that the 19 contracts, awarded without competitive bids, were in compliance with the law.

The Department of General Services states that, in June 1988, it initiated actions to review the procedures and standards for competitive bidding exemptions and for contract-related matters. During this review, the DGS will consider the issues of vendor surveys and contractor evaluations, as addressed in our recommendations. Further, the DGS states that it will present recommendations to the Legislature to improve or eliminate the post-evaluation process. Finally, in January 1989, the DGS will begin auditing the compliance of state agencies with the post-evaluation requirements.

INTRODUCTION

In 1981, legislation transferred existing contract statutes from the Government Code to a new Public Contract Code. In 1982, Chapter 1208, Statutes of 1982, was enacted making significant revisions to the procedures outlined in the original Government Code for approval, evaluation, and control of consultant contracts. To reduce and account for state fiscal expenditures, the Legislature developed methods of applying cost-benefit standards, standards for awarding consultant services contracts by competition, and standards for determining the benefit of consultant services contracts.

The Legislature centralized the administration of and control over consultant contracts within the Department of General Services (DGS). This gave the DGS the responsibility for reviewing and approving all such contracts, while limiting the roles of the Department of Finance and the State Personnel Board to reviewing only those individual contracts that these two control agencies believe are not in compliance with budgetary determinations or merit employment requirements.

The Office of Legal Services within the DGS has oversight responsibility for consultant services contracts. It is also responsible for developing the standard contracting procedures contained in the State Administrative Manual, beginning with

Section 1200, et seq., which includes guidelines for preparing and advertising contracts, using competitive bids, evaluating the need for contracts, and evaluating contractors once contracts are completed.

The Office of Small and Minority Business and the Office of Procurement within the DGS are authorized to approve the exemption of consultant contracts from the competitive bidding requirements of the Public Contract Code. The Office of Small and Minority Business is also responsible for ensuring that competitively bid contracts and contracts exempted from this requirement are advertised in the California State Contracts Register.

The Department of Health Services (department) maintains two contract management sections for the administration of the department's contracts, including those for consultant services: the Office of Procurements and Contracts within the Toxic Substances Control Division and the Contract Consultation and Management Section within the administrative division. These two sections provide administrative and clerical support to all of the department's organizational units requesting consultant services. Both sections are responsible for ensuring that the department is in compliance with all required statutes, regulations, State Administrative Manual policies and procedures, and departmental policies and procedures for awarding contracts. In addition, each section provides consulting services to organizational units seeking competitive bids before the award of a

contract. These services include assistance in developing the two types of contract proposals that can be requested from prospective contractors, Invitations for Bids or Requests for Proposals.

During fiscal year 1986-87, the two contract management sections processed more than 1,400 contracts with public and private entities for services to the department. The 42 consultant contracts, totaling \$2.8 million, that the department reported to the Legislature accounted for 3 percent of the contracts processed by the department that fiscal year. Examples of services obtained through consultant contracts include research, informational studies, program planning, and professional workshops in health-related fields.

SCOPE AND METHODOLOGY

The purpose of this audit was to assess the department's compliance with state laws and regulations for consultant contracts for the review period July 1, 1985, to December 31, 1987. As part of this audit, we reviewed the department's compliance with the provisions of the Public Contract Code that establish the criteria for requesting exemption from competitive bidding requirements; we also examined the DGS' policy and procedures for reviewing and approving those requests. Additionally, we reviewed the organizational structure and functions of the California Public Health Foundation to determine the organization's qualifications for receiving the diversity of consultant contracts awarded to it.

To evaluate the department's compliance with the provisions of the Public Contract Code, we identified 105 consultant contracts awarded by the department during the review period and selected a sample of 46 contracts for review. We evaluated the sample of contracts for compliance with contracting requirements contained in the Public Contract Code and the State Administrative Manual and verified each instance of noncompliance on a contract-by-contract basis. We also reviewed the department's contract management operations and its policies and procedures governing the review and approval of consultant contracts. Finally, we reviewed the department's previous internal audit, "Review of Service and Consultant Contract Processing," December 1986, and we reviewed the "Audit of the Contract Approval Exemption Granted to the Department of Health Services," Report 777, March 1988, that the DGS' Office of Management Technology and Planning conducted.

To evaluate the department's compliance with the requirement in the Public Contract Code that all consultant contracts be competitively bid, we reviewed the department's procedures for requesting exemptions from this requirement. In addition, we examined the DGS' policy and procedures for reviewing and approving the department's requests for exemptions. Furthermore, we assessed the DGS' approval of 23 department consultant contracts that were not competitively bid to determine whether the justification given for

exemption from competitive bidding requirements satisfied the criteria established by the Public Contract Code and stated in the State Administrative Manual. Finally, we examined all 12 contracts awarded to the California Public Health Foundation during our review period to determine the foundation's qualifications for these contracts and whether the justifications for exemption from competitive bidding were valid for each of the awards.

To evaluate the department's compliance with pre- and post-evaluation requirements, we examined the department's rate of compliance with state contracting provisions, and we reviewed its policies and procedures for preparing, requesting, and submitting these documents. We also reviewed the DGS' review and approval policies for consultant contracts and the DGS' enforcement policy of the sections of the Public Contract Code concerning the submission and review of post evaluations for consultant contractors.

To evaluate the department's compliance with the requirements in the State Administrative Manual concerning the award of consultant contracts to current and former state employees, we requested the names and social security numbers of all of the individuals involved with the 46 contracts in our review sample. From the department and our own inquiries of the contractors, we obtained the names of 364 individuals: 12 individual contractors and 352 staff personnel, principal officers, and members of the boards of directors of all

corporations or foundations awarded consultant contracts for the 46 contracts. However, the department, corporations, and foundations could supply only 244 social security numbers for the 364 individuals identified. We then submitted all 364 names and 244 social security numbers to the State Controller's Office to check for previous state employment. For those individuals for whom we had positive verification of previous state employment, we summarized our findings. Finally, we determined whether any of the consultants with previous state employment could have been in violation of the Public Contract Code and submitted the names of those in question to the department for review and any necessary departmental action.

Additionally, to provide information on statewide noncompliance with requirements for contracting with consultants, we reviewed and summarized the findings and agencies' responses to previous reports from the Office of the Auditor General that address compliance with the Public Contract Code. Appendix A presents a summary of the Office of the Auditor General's "State of California Comprehensive Financial and Compliance Audit Report, Year Ended June 30, 1987," F-700, March 1988, concerning statewide contracting compliance. Appendix B presents a summary of the findings on statewide contract management from selected reports of the Office of the Auditor General.

AUDIT RESULTS

I

THE DEPARTMENT OF HEALTH SERVICES DID NOT OBTAIN COMPETITIVE BIDS FOR CONSULTANT CONTRACTS THAT DID NOT MEET THE CRITERIA FOR EXEMPTION

The Public Contract Code requires that all state agencies secure at least three competitive bids or proposals before awarding a consultant contract unless a contract meets specific conditions for exemption from this requirement. However, the Department of Health Services (department) awarded 19 of 46 consultant contracts that we reviewed without obtaining the required competitive bids although the contracts did not meet the specific conditions for exemption. Furthermore, the Department of General Services (DGS) reviewed and approved the department's exemption requests for these 19 contracts even though the DGS could not establish that these contracts met the criteria for exemption established in the State Administrative Manual. As a result, over \$9 million in consultant contracts were awarded without assurance that the department had complied with the law or that the contractors were the lowest responsible bidders meeting standards or the bidders whose proposals were given the highest scores by an evaluation committee.

Authority for Exemption
From Competitive Bidding

Sections 10356 and 10373 of the Public Contract Code require all state agencies to secure at least three competitive bids or proposals before awarding a consultant contract unless a contract meets specific conditions for exemption from this requirement. Section 10356 includes exemptions for contracts that are temporary or that are time-limited appointments to a nontesting civil service classification; contracts for which only travel and per diem expenses are paid; contracts for the sole purpose of obtaining expert witnesses for litigation; contracts for legal defense, legal advice, or legal services; and contracts for less than \$1,000. Section 10373 exempts contracts made in an emergency for the immediate preservation of public health, welfare, or safety or to protect state property; contracts that have been advertised in the California State Contracts Register but have received fewer than three bids or proposals; contracts with another state agency or local governmental entity; and contracts that meet the the conditions prescribed by the DGS in the Public Contract Code, Section 10380. This section states that the DGS must prescribe conditions under which a contract may be awarded without competition, which the DGS does in the State Administrative Manual, Sections 1204 and 5209.

The conditions contained in the State Administrative Manual, Section 1204, include those addressed in the Public Contract Code, Sections 10356 and 10373, two additional exemption criteria, and one additional requirement. Specifically, consultant contracts may be exempted from competitive bidding requirements if the DGS has agreed that there is only a single source for the services or if the director of the DGS determines that the State's interests are better served by exemption. In addition, agencies are required to include a sufficiently detailed explanation to support and justify any instance wherein three bids or proposals cannot be secured or any instance wherein each decision is based on these two additional exemption criteria.

Furthermore, Section 5209 of the State Administrative Manual requires each agency to justify its request for exemption from competitive bidding for Electronic Data Processing contracts to the DGS with a clear demonstration, as a result of an extensive market survey, that only one service or article will properly meet the needs of the State. This market survey must document companies contacted, the dates of contact, and the quotations given for their services.

Sections 1200 and 1203 of the State Administrative Manual establish the DGS as the oversight agency for reviewing consultant contracts. The DGS is responsible for ensuring that the best interests of the State are preserved; that state agencies comply with laws, rules, and regulations; and that expenditures are made as wisely and

economically as possible, considering the needs of the agencies. Furthermore, Section 10360 of the Public Contract Code requires that agencies submit each contract to the DGS, including all papers, estimates and recommendations, for review and approval before the contract is effective.

Requests for Exemption
Did Not Meet Criteria

During a two-and-one-half year period, July 1, 1985, to December 31, 1987, the department sought and obtained exemption from the State's competitive bidding requirements for 71 of the 105 consultant contracts that it awarded. Of these 105 contracts, we reviewed a sample of 46 contracts, 15 of which were competitively bid and 31 of which were granted exemption from competitive bidding. Additional review of the 31 contracts revealed that 19 (61 percent), valued at over \$9 million, were allowed exemption from the State's competitive bidding requirements by the DGS even though 10 of the contracts did not meet the criteria established in the State Administrative Manual and the DGS could not identify the criteria that the remaining 9 contracts met.

The 10 contracts that did not meet the criteria for exemption were among 12 contracts, valued at over \$9.6 million, that had been awarded without competitive bid to one contractor, the California Public Health Foundation (foundation), a private nonprofit organization. On the exemption requests for these 10 contracts, valued

at over \$8.7 million, the department indicated that the foundation was the only entity capable of performing the requirements of the contracts. We randomly surveyed 26 of 49 organizations from two department lists to determine whether any other organizations would have bid on any of the 12 consultant contracts awarded to the foundation if the contracts had been open to competitive bids. We found that, in one-half of the cases, six or more contractors surveyed would have bid to obtain the contract or contracts in question, and, for 9 of 12 contracts, the department could have obtained the three competitive bids required by law when counting the foundation as an additional bidder. Table 1 depicts the results of the contractor survey.

TABLE 1
SURVEY OF THE ABILITY AND WILLINGNESS OF
26 VENDORS TO PERFORM TWELVE CONTRACTS
AWARDED WITHOUT COMPETITIVE BID
TO THE CALIFORNIA PUBLIC HEALTH FOUNDATION

<u>Description of the Contract Awarded</u>	<u>Number of Contracts Awarded</u>	<u>Number of Contractors Responding</u>	
		<u>Could Have Performed the Contract</u>	<u>Would Have Bid on the Contract</u>
Develop Fact Sheets on Specific Chemicals	1	13	10
Establish Monitoring Program for Birth Defects	1	1	1
Prepare Toxic Criteria Documents (Administrative and Technical Support)	1	12	9
Conduct Epidemiological Studies on Adverse Pregnancy Outcomes	1	4	2
Develop and Award Contracts for Regional Cancer Centers and a Central Tumor Registry	2	4	0
Evaluate Complaints of Exposure to Potentially Harmful Substances	1	12	9
Provide Written Health Summaries on Industrial Chemicals	1	9	6
Conduct Environmental Studies Within the State's Hazardous Materials Laboratories	2	16	12
Design and Implement Studies on Infant Botulism	2	2	2

The department's requests for exemption from the competitive bidding requirements indicate that the foundation was created specifically to provide support for the department and that the foundation could provide a unique combination of services and health specialists. However, we reviewed the foundation's role in these 12 contracts and found that the services and staff are not unique to the foundation. In fact, after the award of a contract, the foundation procures or subcontracts with health care specialists to perform the actual work. The foundation administers the contract until its completion and then releases the specialists. The foundation permanently employs less than 10 administrators and clerical staff and has a five-member board of directors, four of which are former department employees. Furthermore, the foundation has subcontracted with the Western Consortium for the Health Professions, Inc., another private nonprofit organization, to provide the internal administrative management.

To determine the criteria that the department had used to justify its requests for exemption from the State's competitive bidding requirements, we reviewed the 31 contracts that were not competitively bid with the chiefs of the department's two contract management sections. We determined that two of the contracts were exempt from the Public Contract Code under provisions specified in the Health and Safety Code. We verified that six more of the contracts met at least one of the requirements for exemption under the Public Contract Code. For the remaining 23 contracts, the chief of the Contract Consultation

and Management Section indicated that the DGS had exempted 22 contracts from the requirement to obtain competitive bids under the provisions of Section 10380 of the Public Contract Code; the department failed to obtain the DGS' approval for exemption for the remaining contract. Section 10380 states that the DGS must prescribe conditions under which a contract may be awarded without competition. According to these conditions set forth in Section 1204 of the State Administrative Manual, the DGS can agree that only a single contractor is capable of performing the requirements of the contract or that the exemption serves the best interests of the State. In addition, Section 5209 of the State Administrative Manual allows the DGS to accept that, for Electronic Data Processing (EDP) contracts, only one service or article meets the needs of the State based on the results of an extensive market survey.

However, during our review of these 23 contracts with the contract manager at the DGS' Office of Small and Minority Business and a senior EDP acquisition specialist at the DGS' Office of Procurement, we could identify only four contracts that appeared to meet the criteria established in the State Administrative Manual for exemption from competitive bidding. The DGS approved the remaining 19 contracts for exemption from competitive bidding even though it could not establish, from the department's exemption requests, that the contracts met the criteria for exemption stated in the State Administrative Manual.

For example, in one of the contracts, the award was made to the foundation because the department felt that the foundation was uniquely suited to acquire highly trained personnel and place them in the State Hazardous Materials Laboratory. The manager in charge of the review at the DGS stated that the DGS approved the request after determining that a competitive bid of the contract would only incur additional costs and delays for a contract that would ultimately be awarded to the foundation anyway. Although the department believed the foundation to be uniquely suited to this contract, in our survey, we identified 16 of 26 potential contractors who indicated that they could have performed this contract, 12 of whom would have bid on this contract if the department had opened it to competitive bids. In addition, in another of the contracts, the department failed to submit the market survey of potential contractors required by Section 5209 of the State Administrative Manual with its request for exemption from competitive bidding for an EDP contract. Despite this omission of required documentation, the DGS reviewed and approved the consultant contract.

According to the director of the DGS, the DGS' Office of Small and Minority Business (OSMB) is responsible for reviewing and approving agency requests for exemption from competitive bidding and represents the DGS' position on this issue. The manager in charge of the reviews of agency requests for exemption at the OSMB stated that there is no written criteria or policy and procedure for reviewing requests submitted for exemption from competitive bidding currently being used

by his analysts. He further stated that the OSMB reviews each contract on a "case-by-case" basis and can base its decision to allow exemption entirely on the justification presented by the department. Finally, he stated that the OSMB usually bases its final decision to approve a request on whether the documentation is convincing or persuasive. However, according to Section 1203 of the State Administrative Manual, the DGS is responsible for ensuring that state agencies comply with laws, rules, and regulations concerning contracts. We conclude that this extends to the DGS' ensuring that agency requests for exemption from competitive bidding meet the criteria required by law.

Because the department and the DGS did not always ensure that the requests for exemption from competitive bidding met the criteria prescribed by law, 19 consultant contracts, valued at over \$9 million, were awarded without verifying that the contractor was the lowest responsible bidder or that the department had complied with the law.

CONCLUSION

The Department of Health Services failed to obtain competitive bids for and the Department of General Services approved 19 (61 percent) of 31 consultant contracts awarded without competitive bids even though the DGS could not establish that these contracts met the criteria for exemption cited in the law. As a result, over \$9 million in consultant contracts were awarded without assurance that the department had

complied with the law or that the contractors were the lowest responsible bidders meeting standards or the bidders whose proposals were given the highest scores by an evaluation committee.

RECOMMENDATIONS

To ensure that it complies with the provisions of the Public Contract Code and obtains the most qualified bidder, the Department of Health Services should request competitive bids for consultant contracts or ensure that the contracts meet the criteria established in the Public Contract Code for exemption from this requirement.

To ensure that agencies are complying with the law, the DGS should approve exemptions from competitive bidding requirements for consultant contracts only when state agencies clearly demonstrate that contracts meet the criteria prescribed in the State Administrative Manual. Furthermore, this demonstration should include an extensive survey of all potential vendors for all consultant contracts.

II

THE DEPARTMENT OF HEALTH SERVICES DID NOT COMPLY WITH ALL REQUIREMENTS FOR AWARDING AND MANAGING CONSULTANT CONTRACTS

In addition to awarding consultant contracts without first obtaining the required competitive bids, the department did not always comply with other statutory requirements concerning consultant contracts. Specifically, the department did not always submit to the DGS post evaluations for consultant contractors upon completion of consultant contracts. Nor did the department review the contractor post evaluations on file with the DGS before awarding consultant contracts. In addition, the department did not always obtain approval before the starting dates of consultant contracts. Further, the department did not review the employment history of all contractors to ensure that current and former state employees were not receiving consultant contracts to which they were not legally entitled. Finally, the department did not report the award of all consultant contracts over \$5,000 to the Department of Fair Employment and Housing and all consultant contracts to the Legislature, as required. Because the department did not comply with these requirements, it could not assure the State that all of the consultant contracts were awarded to the best qualified contractor, were awarded fairly, or were awarded in compliance with the law.

Review and Submission of Contractor Post Evaluations

Sections 10369 through 10371 of the Public Contract Code require that, within 30 days of the completion of a contract, every state agency complete a post evaluation for each consultant contract that the agency awards and send a copy of each post evaluation to the DGS' Office of Legal Services (legal office). Failure to send a post evaluation to the legal office constitutes grounds for the DGS to restrict or terminate the authority of a department to enter into consultant contracts. These sections of the code also require the DGS' legal office to retain the post evaluations and make them available to agency directors upon written request. The code further states that a consultant contract will not be awarded unless the department has reviewed the contractor's post evaluation on file with the DGS' legal office. Or, if the contractor has not previously contracted with the State, the department must request and review a completed resume for each contract participant who will exercise a major role in the contract and must attach it to the contract file.

However, upon the completion of 31 consultant contracts in our review, the department failed to submit 5 (16 percent) post evaluations of contractors to the DGS. In addition, the department did not request or review the post evaluations of contractors on file with the DGS' legal office for the remaining 41 (89 percent) of 46 consultant

contracts awarded in our review sample; however, for the remaining 5, we found resumes in the department's contract files. Furthermore, the DGS' legal office reviewed and approved 26 of the 46 contracts in our review even though the department had not reviewed the post evaluations of the contractors on file with that office, as required by law. Further review of the DGS' records of all requests made for post evaluations of contractors revealed that the department had never requested a post evaluation from the DGS before awarding any contract during our review period.

The department's failure to submit five post evaluations to the DGS' legal office resulted from an oversight on the part of the department personnel responsible for completing and forwarding the documents. However, the DGS' legal office reviewed and approved three of these contracts and did not enforce the requirement that the department submit the post evaluations upon completion of the contracts.

The department responded to the findings that it did not review post evaluations on file with the DGS with a statement from the chief of its Contract Consultation and Management Section forwarded through the deputy director of administration. In this response, the chief stated that the Public Contract Code does not specify that the contractor post evaluations are to be used to reject a bid or contractor because of a previous unsatisfactory performance. Further, he stated that, because of the unique nature of many of the

department's contracts, it is better for the department to award contracts to qualified bidders only on the basis of responsibility tests incorporated in the evaluation and selection criteria in the Requests for Proposal. Finally, he stated that, in the case of contracts awarded for emerging public health issues without competitive bids, the department is the primary source of information regarding the expertise of these contractors; thus, the post evaluations stored at the DGS for these cases would be unlikely to provide relevant information about such organizations.

Although the department does not see a need to review these post evaluations, we conclude that Section 10355 of the Public Contract Code intended that the post evaluations be used by state agencies to apply uniform standards for awarding consultant contracts and for determining the benefit of those contracts. Although the department may establish qualified bidders by responsibility tests incorporated in the Requests for Proposal, these requests were used for less than one-third of the contracts awarded to consultants by the department during our review period, and the department had no formal way to evaluate the remaining two-thirds of all consultant contracts. Finally, the department's assumption that relevant information is unlikely to be available at the DGS is questionable given that the department never requested the post evaluations for any contractor to whom it awarded contracts during our review period.

The DGS did not enforce the requirement that each state agency file an evaluation for each contractor upon the completion of the contract, and it reviewed and approved contracts from the department for which the department had not reviewed the contractor evaluations before the award of the contract, as required by law.

According to the chief counsel of the DGS' legal office, the DGS does not ensure that state agencies review contractor post evaluations before awarding contracts because the Public Contract Code does not expressly require the DGS to take any action. Also, he stated that the DGS is not aware of whether every state agency has filed all of the evaluations required or whether any agencies have consistently failed to submit them. Further, he stated that to successfully implement a procedure that would ensure the submission of post evaluations would require substantial time and material and would be inappropriate for a program that the department has found to be "not very effective." Finally, he stated that, in his opinion, the expenditure required to make the program effective would be "economically wasteful" as defined in the Government Code, Section 10542. Economically wasteful actions are discussed in (b)(2) of this section, which addresses "improper governmental action(s)" by agencies or employees in the performance of their duties.

We conclude, however, that Section 1203 of the State Administrative Manual requires the DGS to meet its responsibilities in reviewing contracts and ensuring that state agencies comply with laws,

rules, and regulations. This responsibility logically extends to ensuring that state agencies submit and review post evaluations kept in the DGS' legal office before the DGS approves a department's contract award to a consultant.

As a result of the department's failure to comply with the Public Contract Code, the department awarded 41 consultant contracts in our review sample, worth over \$12.8 million, without evaluating each consultant's previous contract performance with the State, as required by law. Furthermore, because the department failed to adhere to the state requirements for submitting post evaluations for each contractor and the DGS' legal office does not enforce this requirement, the State cannot rely on this system of contractor post evaluations to protect its best interests.

In 1986, the Office of the Auditor General recommended that the DGS review the effectiveness of the post-evaluation process and make recommendations to the Legislature to improve or eliminate the process. Although the Secretary of State and Consumer Services Agency assured the Office of the Auditor General of a response by June 1987, the DGS is still finalizing its report and, on July 21, 1988, stated that it expected to issue its findings by September 1988. However, in the DGS' response to this report, dated October 12, 1988, the DGS stated that it is reviewing the requirements and will present to the Legislature recommendations to improve or eliminate the post-evaluation process. The DGS has not specified when it will present these recommendations.

Failure To Obtain Contract Approvals

Section 10360 of the Public Contract Code states that consultant contracts are not in effect unless and until approved by the DGS. However, Section 10364 of the Public Contract Code allows an exemption to state agencies from this requirement for all contracts of a class or type under \$50,000 if the DGS decides that its approval is unnecessary; state agencies granted this exemption, nevertheless, must continue to meet specific administrative requirements. Furthermore, Section 1206 of the State Administrative Manual states that, generally, the DGS must approve all contracts and interagency agreements, with the exception of contracts for \$10,000 or less or interagency agreements for \$25,000 or less. This requirement is in effect for all agencies unless the DGS extends an agency's exemption limit under the provisions of Section 10364 of the Public Contract Code.

Of 105 contracts awarded during our review period, we examined 46 contracts and found that the department had failed to approve or obtain the DGS' approval before the starting date recorded on 40 (89 percent) of the contracts until 60 days, on the average, after the contract starting date. To determine whether work had been started on any of these contracts before the final approval, we reviewed the invoices and accounting ledgers for these contracts at the department. For 22 (48 percent) contracts, we found that work had been started before the final contract approval, in violation of Section 10360 of the Public Contract Code. Furthermore, the department had failed to

approve 5 of these 22 contracts until 22 days, on the average, after the completion of the contract.

In a response forwarded through the deputy director of administration, the chief of the Contract Consultation and Management Section stated that the failure to obtain contract approval before the starting dates of contracts resulted from the influx of more than 1,000 contracts received by the section at the end of each fiscal year for contracts for the following fiscal year. He stated that this influx occurs because the department's program personnel wait to submit the requests for contract review and approval until after the department's annual budget has been approved and they know which aspects of their program are still funded. The chief also stated that late approval of most consultant contracts occurs because most of these contracts involve rapidly emerging public health issues, such as contracts for AIDS research.

Despite the claim of an annual influx of approval requests at the end of each fiscal year, we found that the approvals for 17 (77 percent) consultant contracts out of the 22 contracts that were approved after the work had been started were not requested at the end of the fiscal year but at varying times during the year. Moreover, these 17 contracts were approved 56 days, on the average, after the starting dates on the contracts, including all five contracts that were not approved until after the completion of the contract. Furthermore, although some of the contracts were approved late because of rapidly

emerging health issues, we concluded, in the Office of the Auditor General's report, "A Review of the State's Spending Related to the Acquired Immune Deficiency Syndrome," P-658, April 1987, that the department still must allow its staff sufficient time to process each request before the starting date of the contract, regardless of how quickly it needs to implement programs.

Because the department failed to obtain contract approval before the work had been started on the 22 contracts, the State was exposed to potential liability for work performed by the contractors before the contracts were approved. Furthermore, the State was exposed to potential litigation between the State and the contractor over payment for services rendered by the contractor should the DGS disapprove the contract.

Additional Contract Approvals Not Obtained

In addition to obtaining approval of consultant contracts before work begins, state agencies must obtain certain other contract and amendment approvals. Section 1216 of the State Administrative Manual states that the department will obtain the DGS' approval for exemption from competitive bidding for any contract amendment that exceeds 30 percent of the original contract amount or causes the amended contract amount to exceed the department's \$10,000 approval authority allowed for contracts by Section 1206 of the State Administrative Manual. Section 10371(b) of the Public Contract Code

states that any state agency that enters or expects to enter into more than one consultant contract with the same contractor within a 12-month period for an aggregate amount of \$10,000 or more shall have each contract exceeding the aggregate amount approved by the DGS.

However, we found that the department failed to request the DGS' approval for exemption from competitive bidding for contract amendments of greater than 30 percent for two contracts. Furthermore, we found that the department failed to request the DGS' approval for one amendment and one contract that caused the contract amount to exceed the department's exemption limit. These failures to obtain the required DGS approvals for contract amendments occurred because of oversights by review staff within the contract management sections while processing the contracts.

The department's failure to obtain the DGS' approval of contract amendments and a contract that exceeded the department's exemption limit hinders the ability of the DGS to ensure that contracts are awarded fairly and are in the best interests of the State.

Failure To Review Employment History

Section 10410 of the Public Contract Code does not allow state agencies and departments to enter into a consultant contract with a current state employee or appointed state official unless the service demanded by the contract is required as a condition of the employee's

regular state employment. Furthermore, Section 10411 of the Public Contract Code does not allow any state agency to enter into a contract with a former state employee for two years from the date that the employee left state service if, while employed with the State, that person was engaged in any of the negotiations, transactions, planning, or arrangements or in any part of the decision-making process relevant to the contract. Nor does this section allow any state agency to enter into a contract with a former state employee for one year from the date that the employee left state service if that person was employed in a policy-making position in the same general subject area as that of the proposed contract.

In addition to these limitations for contracting with current and former state employees, Sections 10367, 10368, and 10360 of the Public Contract Code state that the DGS will devise standards and criteria on preevaluation forms for the preevaluation of contractors, that agencies entering into consultant contracts will complete these forms, and that these forms will be submitted to the DGS once completed. One of the standards of review on the preevaluation form requests whether state agencies have complied with all the requirements governing the employment of current and former state employees as specified in Section 1248 of the State Administrative Manual; Section 1248 of the State Administrative Manual restates Sections 10410 and 10411 of the Public Contract Code regarding contracting with current and former state employees.

We found, however, that the department does not review the employment history of most potential consultants to ensure that the Public Contract Code is not being violated. In addition, the department does not notify potential contractors, in the text of the completed contracts, of these employment restrictions. Using the social security numbers provided, we reviewed the employment histories of 244 of the employees involved with the 46 consultant contracts in our sample. From the sample of 244, we identified 57 people (23 percent) who had employment histories with the State. Fifteen worked under consultant contracts concurrently as state employees, and we determined that six of them did so in violation of Section 10410 of the Public Contract Code. Of the remaining 42 employees, 18 had not worked for the State for at least three years. Ten more had worked as consultants for the department within one to three years of leaving state service, and 14 had worked for the department as consultants within one year of leaving state service. However, our review of these 42 employees did not reveal any instance when the department appeared to have violated the Public Contract Code by awarding a contract to a consultant who was not legally entitled to it.

In a response forwarded through the department's deputy director of administration, the chief of the Program Support Branch stated that the Public Contract Code establishes policy regarding contracting with current or former state employees but does not establish specific requirements for procedures. Furthermore, she stated that the DGS has not expanded upon the requirements in the law.

However, she concluded, to ensure compliance with the law, the department has implemented internal policies and procedures requiring the contractors to identify key personnel and respective work histories for "most Requests for Proposal." Also, she stated that the department has added a requirement that program staff consult with the department's legal office to review potential conflicts of interest on a case-by-case basis.

The department, however, could not provide us with written documentation of the internal policies that the chief of the Program Support Branch stated had been implemented to ensure compliance with this requirement. Furthermore, even an informal understanding and enforcement of these policies would ensure compliance only for "most Requests for Proposal" and not at all for Invitations for Bids or for the single greatest category of consultant contracts: those that are not competitively bid. In addition, even though the DGS does not specifically outline procedures that the department should follow when reviewing the employment histories of contractors, the DGS does require that the department ensure compliance with the law through a positive response on question seven of the preevaluation form. A positive response signifies that the department has ensured that the consultant contractor is not in violation of the Public Contract Code, an assurance that the department routinely makes.

Because the department did not ensure that consultant contracts were not awarded to current state employees who were not entitled to receive them, six employees were in violation of Section 10410 of the Public Contract Code. The department has taken action to recover the payments made to one employee and has concluded that the payments made to the remaining five employees were not materially significant enough to warrant restitution. Finally, the department concluded that, in the circumstances under which the contracts were awarded, the infractions were not substantial enough to warrant the remedies and penalties specified in the Public Contract Code.

Failure To Submit Required Reports

Section 10359 of the Public Contract Code requires state agencies to report the award of all consultant contracts to the Legislature. This section further states that these reports shall be sent to the Legislative Analyst, the Department of Finance, the Office of the Auditor General, the Senate Finance Committee, and the Assembly Ways and Means Committee. Furthermore, Section 1212.11 of the State Administrative Manual requires all agencies to report the award of all contracts over \$5,000 to the Department of Fair Employment and Housing within ten working days of the award date.

However, the department failed to report to the Legislature 15 (14 percent) of the 105 consultant contracts that we reviewed, as required by the Public Contract Code. In addition, the department failed to report 10 (28 percent) of 36 contracts over \$5,000 that we reviewed to the Department of Fair Employment and Housing, as required by the State Administrative Manual.

The department's failure to report the award of the contracts to the Legislature weakened the ability of the legislative branch to effectively review agency programs and spending. Furthermore, the administrator of the Office of Compliance Programs at the Department of Fair Employment and Housing stated that the department's failure to report the 10 contract awards may have prevented the Department of Fair Employment and Housing from monitoring the equal employment opportunity practices of these contractors, as required by state guidelines and policies against discriminatory practices.

The chief of the Contract Management and Consultation Section stated that failure to report 15 consultant contracts to the Legislature occurred because of an internal oversight. The chief also stated that, because program personnel did not submit the notification of contract awards over \$5,000 to the Department of Fair Employment and Housing, the department has changed its policy to ensure compliance. Finally, as reported in the Office of the Auditor General's Audit Report, "The State Has Not Adequately Monitored the Reporting and Evaluation of Consulting Services Contracts," F-322, February 1984,

those offices receiving the consultant contract reports are not responsible for ensuring that all state agencies submit complete reports on time. Also, as reported in the Office of the Auditor General's report, "The State Needs To Improve Its Control of Consultant and Service Contracts" P-504, April 1986, no entity has enforced compliance with the requirement for reporting to the Legislature.

CONCLUSION

The Department of Health Services did not always comply with certain requirements of the Public Contract Code when awarding consultant contracts. Specifically, because of oversight by department personnel, the department did not submit post evaluations of all consultant contractors to the DGS. In addition, the department did not review the contractor post evaluations at the DGS before awarding contracts because the department did not believe that it would receive relevant information. The department also did not always obtain the required contract approvals before work had been started on consultant contracts, resulting in the department's inability to ensure that all consultant contract awards complied with the law. Further, because of a lack of specific procedures, the department does not ensure that current and former state employees are not receiving consultant contracts to which they are not legally entitled. Finally, because of internal oversights and failure of the department's personnel to submit

notification of contract awards, the department did not meet all of its reporting requirements.

RECOMMENDATIONS

To ensure that it complies with the requirements for awarding consultant contracts, the Department of Health Services should take the following actions:

- Submit post evaluations within 30 days of the completion of a contract, and review the post evaluations of potential contractors before awarding consultant contracts;
- Require its staff to initiate the processing of contracts early enough to ensure that the contracts are approved before their starting dates;
- Obtain the DGS' approval for contracts that are amended for over 30 percent of the original contract amount or for more than the department's exemption authority;
- Include language within the contract provisions of each contract notifying the contractor of state laws concerning current or previous employment with the State as it pertains to the award of consultant contracts;

- Require all consultants to submit employment histories for department review before awarding contracts;
- Recover the compensation paid to state employees who worked concurrently as consultants in violation of the Public Contract Code;
- Submit to the Department of Fair Employment and Housing notification of all contract awards over \$5,000, and report the ten contracts that it did not report; and
- Report all consultant contracts to the Legislature, and send an amended report that includes the 15 omitted consultant contracts.

To ensure that state agencies are in compliance with the requirements of the Public Contract Code regarding the use of post evaluations for consultants, the Department of General Services should take the following actions:

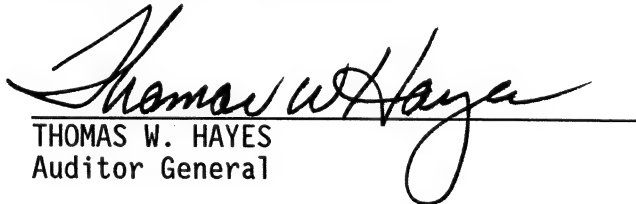
- Enforce the provisions of the code requiring that state agencies submit post evaluations for consultants within 30 days after the completion of the contracts; and

- Ensure that state agencies review contractor post evaluations before awarding consultant contracts.

Finally, the DGS should finalize its response to the Office of the Auditor General's recommendations of April 1986 and present its recommendations to the Legislature to improve or eliminate the post-evaluation process.

We conducted this review under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,



THOMAS W. HAYES
Auditor General

Date: October 17, 1988

Staff: William S. Aldrich, Audit Manager
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APPENDIX A

SUMMARY OF FINDINGS OF THE OFFICE OF THE AUDITOR GENERAL'S "STATE OF CALIFORNIA COMPREHENSIVE FINANCIAL AND COMPLIANCE AUDIT YEAR ENDED JUNE 30, 1987," F-700, MARCH 1988

The following is a summary of common contracting deficiencies found during the Office of the Auditor General's statewide audit for fiscal year 1987.

Deficiencies in Administering State Contracts

State agencies do not always comply with the Public Contract Code in establishing and maintaining contracts. During a statewide review of 160 contracts at 16 agencies, we found 80 contracts that did not fully comply with provisions of the Public Contract Code. For example, 30 contracts were not approved before the beginning of the contract work. As a result, the State may be liable for invalid contracts. Additionally, 42 contract files did not contain contractor evaluation forms prepared within 30 days of completion of the contracts, and 26 contracts lacked other required documentation. Lack of contractor evaluations may cause the State to enter into contracts with unreliable vendors. Finally, 16 contracts failed to comply with other provisions of the Public Contract Code. Table A-1 provides details of the test results.

Deficiencies in Administering State Consultant Contracts

Further review of the audit workpapers revealed that 40 (25 percent) of the 160 contracts in our statewide testing were for consulting services. Evaluating these specific consultant contracts, we found 20 contracts (50 percent) that did not fully comply with provisions of the Public Contract Code. For example, 7 consultant contracts (18 percent) were not approved before the beginning of the contract work. Additionally, 11 consultant contract files (28 percent) did not contain contractor post-evaluation forms prepared within 30 days after the completion of the contracts, and 6 contracts lacked other required documentation. Finally, 7 consultant contracts (18 percent) failed to comply with other provisions of the Public Contract Code. Table A-2 provides details of the test results for the 40 consultant contracts reviewed.

TABLE A-1
DEFICIENCIES IN ADMINISTERING STATE CONTRACTS AT VARIOUS AGENCIES
FISCAL YEAR 1986-87

<u>Organization</u>	<u>Number of Contracts Reviewed</u>	<u>Number of Contracts Reviewed With at Least One Exception</u>	<u>Lack of Approval Before Start of Contract Work</u>	<u>Lack of Prompt Contractor Post Evaluations</u>	<u>Lack of Required Documentation (Except Evaluations)</u>	<u>Lack of Other Required Procedures</u>
California Community Colleges, Chancellor's Office	10	4	2	2		
California Exposition and State Fair	10	8		8	5	
California Student Aid Commission	10	4	1	1	2	
Corrections, Department of	10	5		2	3	3
Education, State Department of	10	5		3	3	
Employment Development Department	10	7		4	6	1
Equalization, Board of	10	2		2		
Franchise Tax Board	10	9	9	2		3
General Services, Department of	10					
Health Services, Department of	10	8	8	1		
Mental Health, Department of	10	5		4		1
Motor Vehicles, Department of	10	5		5		
Social Services, Department of	10	10	7	3	5	4
State Controller's Office	10	5	3	4		3
State Treasurer's Office	10	3		1	2	
Transportation, Department of	<u>10</u>	—	—	—	—	<u>1</u>
Total	<u>160</u>	<u>80</u>	<u>30</u>	<u>42</u>	<u>26</u>	<u>16</u>

TABLE A-2

DEFICIENCIES IN ADMINISTERING STATE CONSULTANT CONTRACTS AT VARIOUS AGENCIES
FISCAL YEAR 1986-87

<u>Organization</u>	<u>Number of Contracts Reviewed</u>	<u>Number of Contracts Reviewed With at Least One Exception</u>	<u>Lack of Approval Before Start of Contract Work</u>	<u>Lack of Prompt Contractor Post Evaluations</u>	<u>Lack of Required Documentation (Except Evaluations)</u>	<u>Lack of Other Required Procedures</u>
California Community Colleges, Chancellor's Office	8	3	2	1		
California Exposition and State Fair	0					
California Student Aid Commission	1					
Corrections, Department of	2	2	1			1
Education, State Department of	4	4		3	3	
Employment Development Department	4	1				1
Equalization, Board of	6	2		2		
Franchise Tax Board	0					
General Services, Department of	2					
Health Services, Department of	1	1	1			
Mental Health, Department of	1	1		1		1
Motor Vehicles, Department of	0					
Social Services, Department of	2	2	1	1	2	1
State Controller's Office	5	3	2	3		3
State Treasurer's Office	3	1			1	
Transportation, Department of	<u>1</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total	<u>40</u>	<u>20</u>	<u>7</u>	<u>11</u>	<u>6</u>	<u>7</u>

APPENDIX B

SUMMARY OF FINDINGS ON STATEWIDE CONTRACT MANAGEMENT FROM SELECTED REPORTS OF THE OFFICE OF THE AUDITOR GENERAL

The following is a summary of two previous audit reports released by the Office of the Auditor General concerning deficiencies in the administration of state contracts.

In "The State Has Not Adequately Monitored the Reporting and Evaluation of Consulting Services Contracts," Report F-322, February 1984, we found the following conditions:

- State agencies were not submitting complete quarterly reports on time for their consultant contract activity, as required by the Government Code, Section 14830.4. Less than one-third of the state agencies that had budgeted for consulting and professional services during fiscal year 1982-83 submitted quarterly reports to the Office of the Auditor General.
- Sometimes agencies were not submitting post evaluations for completed consultant contracts, as required by Section 14830.14 of the Government Code. We determined that the Department of General Services was partially responsible for failing to provide the agencies with the appropriate evaluation forms by January 1, 1988. In a sample of 50 contracts completed after January 1, 1983, we discovered that post evaluations for 22 (44 percent) of those contracts were not on file at the Department of General Services' legal office as of September 23, 1983.

In "The State Needs To Improve Its Control of Consultant and Service Contracts," Report P-504, April 1986, we found the following conditions:

- Because the Department of General Services (DGS) did not conduct comprehensive audits of contracts that it did not review and approve, it did not adequately monitor all contracts awarded by state agencies. Although it adequately reviewed and approved the contracts over \$10,000, it did not enforce controls for the award of all contracts under \$10,000. Contracts for \$10,000 or less have the potential for greatest misuse of state funds because most consultant and services contracts are within this range and undergo no external review. For example, in our review of contracts at five state agencies for fiscal year 1984-85, 73 percent of all

contracts were \$10,000 or less. As a result of inadequate monitoring, the DGS could not evaluate whether state agencies were awarding contracts in the best interests of the State.

- State agencies did not always implement contract management systems or award contracts according to standards provided by the Public Contract Code and the State Administrative Manual. Furthermore, some state agencies had awarded consultant and service contracts that were not in the best interests of the State because of incomplete contract management systems or because of direction from state agency management to circumvent the controls.
- State agencies did not always comply with specific provisions of the Public Contract Code that are intended to provide greater accountability for and control over the award of consultant and service contracts. We noted the following specific examples:
 - State agencies did not prepare and submit to the Department of General Services post evaluations of contracts once contractors have completed the projects. Of the 124 completed contract files at the five state agencies in our review, 97 (78 percent) lacked post evaluations. Contract coordinators failed to prepare post evaluations for the contractors in 22 (88 percent) of the 25 contracts over \$10,000 and 75 (76 percent) of the 99 contracts under \$10,000.
 - State agencies did not review the post evaluations retained by the department before awarding consultant contracts.
 - State agencies did not submit required quarterly reports that show consultant contract activity. Only 33 (38 percent) of 86 state agencies that spent funds for consulting and professional services in fiscal year 1983-84 submitted three or all four of the required reports for that year. For the first three quarters of fiscal year 1984-85, only 26 of 99 state agencies spending funds for consulting and professional services had submitted all three required reports.
- State agencies frequently award contracts to employees of the California State University and the University of California. In addition to performing work for the State, university employees also perform contract work for the federal and local governments and for private firms and associations.

DEPARTMENT OF HEALTH SERVICES

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October 12, 1988

Mr. Thomas W. Hayes
Auditor General
Office of the Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Hayes:

Mr. Clifford L. Allenby, Health and Welfare Agency, has asked me to respond to your report entitled "The Department of Health Services Does Not Comply With All Requirements for Awarding and Managing Consultant Contracts". In addition to responding to each of the conclusions and recommendations in the body of the report, I am also providing comments on some of the points made in the "Results in Brief" section of the executive summary. As executive summaries generally are the focus of attention by many of the readers of your report, I believe it is important to highlight the Department's position on these matters.

We would request that the title of the report be less negative and recommend it be entitled "Review of the Awarding and Managing of Consultant Contracts by the Department of Health Services". ①*

RESULTS IN BRIEF SECTIONIssue: Failure to Meet Exemption Requirements in Public Contract Code

"The department awarded 19 consultant contracts, for over \$9 million, without obtaining at least three competitive bids or meeting the exemption requirements in the Public Contract Code."

Comments: Public Contract Code, Section 10380, allows Department of General Services (DGS) to proscribe conditions under which a contract may be awarded without competition. DGS has done so in Section 1204 of the State Administrative Manual (SAM). Section 1204 of SAM includes a provision that three competitive bids are not required for "Contracts where the Department of General Services has agreed that there is but a single source for the services; and those contracts as to which the Director of General Services determines that the State's interests are better served by exemption." The 19 consultant contracts referred to by the Auditor General staff were all submitted to DGS for this approval prior to award. The Department believes the statement "without meeting exemption requirements in the Public Contract Code" to be a judgment by Auditor General staff. We elaborate further on this point later in the letter. ②

*The Office of the Auditor General's comments on specific points contained in this response appear on page 53.

Issue: Contract Postevaluations

"The department did not always comply with the requirement for submitting contractor postevaluations to the Department of General Services (DGS) upon the completion of a contract in 5 (16 percent) of 31 contracts in our sample and did not review any of the previous postevaluations for consultants on file with the DGS before awarding the 105 consultant contracts during our review period."

Comments: This "result" is an accurate statement. However, the Department has made significant efforts to complete 1987-88 contractor postevaluations.

Issue: Work Begins on Contracts Before They Are Approved

"The department began work on 22 of the contracts before obtaining contract approval and failed to seek DGS's approval for one contract and three amended contracts that exceeded the department's authority to exempt without DGS's approval."

Comments: The Department did not begin work on contracts prior to approval; contractors did. (3)

Department of Health Services (DHS) contractors are notified routinely that contracts are not valid until they have been fully executed (e.g., approved either by DGS or, where the Department has delegation, approved by the Department's Contract Manager). The 22 contractors received no payments for work performed until a fully executed contract was in place. (4)

Failure to obtain DGS's approval for two of the amendments referred to by the Auditor General was for the following reason: In December 1984, SAM was changed to include a requirement that all contract amendments that increased contract amounts by more than 30 percent would require DGS approval. The Department did not receive notification of this change until several months later. Hence, the Department inadvertently approved two amendments that exceeded 30 percent of the original contract amount. The other two errors identified by the Auditor General were due to processing oversights.

Issue: Contracting With Current and Former State Employees

"The department does not ensure that former and current state employees are not receiving consultant contracts to which they are not legally entitled."

Comments Neither the Public Contract Code nor the State Administrative Manual define procedures for ensuring compliance with Public Contract Code Sections 10410 and 10411. The Department had relied upon Conflict of Interest and Incompatible Activities policies contained in the Health Administrative Manual as well as included requirements for submittal of work histories of potential personnel in most Requests for Proposal. The Auditor General review revealed, however, that departmental policies and

procedures did not prevent several instances of dual employment (two current employees work half time for the Department and half time for a contractor). We will correct this problem by implementing the Auditor General's recommendation to include provisions in contracts that preclude inappropriate use of current or former State employees.

Issue: Errors in Preparing Consultant Contract Reports

"The department did not report 15 (14 percent) of 105 consultant contracts to the Legislature during our review period. In addition, for 10 (28 percent) of the 36 contracts for over \$5,000 that we reviewed, the department did not report its award to the Department of Fair Employment and Housing, as required by law."

Comments: The 15 unreported consultant contracts referred to by the Auditor General were entered into by the Toxic Substances Control Division during the year subsequent to that Division assuming responsibility for their own contract processing. Due to an oversight, these 15 contracts were not included in the departmental report prepared by Contract Management Section. An amended report including these contracts has been prepared and will be forwarded to the Legislature.

During the first year of implementation of the Department of Fair Employment and Housing reporting requirement, DHS assigned responsibility for compliance to the programs. The second year, departmental policy was modified to require that programs complete the Department of Fair Employment and Housing reporting requirement at the time the contract is submitted for approval. The Department has been 100 percent in compliance with this requirement for the last two years. Therefore, the corrective action appears to have been successful.

We offer comments on the conclusions and recommendation in the text of report as follows:

CONCLUSION

"The Department of Health Services failed to obtain competitive bids for and the Department of General Services approved 19 (61 percent) of 31 consultant contracts awarded without competitive bids even though the DGS could not establish that these contracts met the criteria for exemption cited in the law. As a result, over \$9 million in consultant contracts were awarded without ensuring that the contractor was the lowest responsible bidder or that the department complied with the law."

Comments: The Department submitted and received DGS approval to award the 19 contracts referred to by the Auditor General. All of these contracts met either the specific criteria for exemption from competitive bidding enumerated in the Public Contract Code or one of the two additional conditions for exemption proscribed by DGS in SAM, Section 1204. Auditor

General staff, however, have concluded that DHS did not provide substantial documentation to support DGS approval that these requests were in compliance with the law. They base their conclusion, in part, on a survey wherein they asked 26 vendors whether or not they could have bid on 12 contracts that were awarded without competitive bid to the California Public Health Foundation.⁵ It is difficult to refute this conclusion without specifically addressing the justification for each of the 19 contracts; however, a discussion of two of the contracts in question (one not included in the vendor survey conducted and one included) may illustrate our contention that the Department was in compliance with the law.²

In 1986, the Department requested approval to contract without competitive bidding with Children's Hospital of Los Angeles for laboratory procedures and qualified medical consultative ability to protect newborn infants from retardation, cataracts, and death resulting from undetected and untreated galactosemia. This hospital operates the only laboratory in the State that provides these services; furthermore, this laboratory provides these services to 50 percent of the galactosemic children in the United States. Since the Department also licenses and accredits all laboratories in the State, we have first-hand knowledge that this is the only facility in California where all the required tests can be performed and compared by pediatric metabolic experts to other galactosemia cases in order to determine whether or not immediate action must be taken to avoid severe illness or death of newborn babies. We fail to understand what public purpose would have been served by advertising this need for services and inviting competitive bids when we already knew that only one facility could effectively provide this service. Further, even if there were another facility that was interested in entering into the "business" (at a lower cost) of advising mothers within 24 hours of the need to take their babies off all milk products and introduce appropriate nutritional substitutes in order to avoid serious retardation or, possibly, death, we would question the medical ethics of entering into such a contract. We do not believe it is in the State's best interests to enter into contracts for this type of service with unproven, but lower cost, facilities. Perhaps DGS could have, and should have, asked the Department to provide more substantiation at the time the request was approved; however, this example, we believe, does demonstrate that the State's best interests were better served by exemption.

In 1985, the Department requested approval to sole source a contract with the California Public Health Foundation to conduct three epidemiological studies to examine the relationships between certain toxic chemicals and adverse reproductive outcomes in Santa Clara County. The three studies were as follows: (1) examine spontaneous abortions, birth defects, prenatal mortality, and low birth weight in relation to chemical exposures in air and water in four census tracts; (2) ascertain rates of cardiac defects and determine the need for further investigations of possible factors; and (3) examine the feasibility of an ongoing population-based spontaneous abortion program. The Department highlighted nine points in support of justification for this sole source request. We believe two of these points, the need for

rapid start-up to deal with the critically emerging public health concerns in this county and the avoidance of contracting with private consultants who may have other clients that would be affected by the outcome of these studies, strongly supported the case that it was in the State's best interest to enter into this contract without competitive bidding.

RECOMMENDATION

"To ensure that it complies with the provisions of the Public Contract Code and obtains the most qualified bidder, the Department of Health Services should request competitive bids for consultant contracts or ensure that the contracts meet the criteria established in the Public Contract Code for exemption from this requirement."

Comments: We concur with this recommendation.

CONCLUSION

"DHS did not always comply with certain requirements of the Public Contract Code when awarding consultant contracts. Specifically, because of oversight by department personnel, the Department did not submit postevaluations of all consultant contractors to DGS. In addition, the Department did not review the contractor postevaluations at DGS before awarding contracts because the Department did not believe that it would receive relevant information. The Department also did not always obtain the required contract approvals before the work started on consultant contracts, resulting in the Department's inability to ensure that all consultant contract awards complied with the law. Further, because of the lack of specific procedures, the Department did not ensure that current and former state employees were not receiving consultant contracts to which they were not legally entitled. Finally, because of internal oversights and failure of the Department's personnel to submit notification of contract awards, the Department did not meet all of its reporting requirements."

Comments: We believe the Department's comments on these matters have been incorporated in the text of the report.

RECOMMENDATIONS

To ensure that it complies with the requirements for awarding consultant contracts, DHS should take the following actions:

- . "Submit postevaluations within 30 days of the completion of a contract, and review the postevaluations of potential contractors before awarding consultant contracts."

Comments: The Department concurs with this recommendation.

- . "Require its staff to initiate the processing of contracts early enough to ensure that the contracts are approved before their starting dates."

Comments: The Department concurs with this recommendation.

- . "Obtain DGS's approval for contracts that are amended for over 30 percent of the original contract amount or for more than the department's exemption authority."

Comments: The Department concurs with this recommendation.

- . "Include language within the contract provisions of each contract notifying the contractor of state laws concerning current or previous employment with the State as it pertains to the award of consultant contracts."

Comments: The Department will implement this recommendation.

- . "Require all consultants to submit employment histories for department review before awarding contracts."

Comments: The Department does not disagree with this recommendation. We will, however, look at the feasibility of implementation.

- . "Recover the compensation paid to state employees who worked concurrently as consultants in violation of the Public Contract Code."

Comments: The Department does not necessarily agree that six employees were in violation of the Public Contract Code. The Department has initiated action to recover inappropriate compensation paid to one employee. (6)

- . "Submit to the Department of Fair Employment and Housing notification of all contract awards over \$5,000, and report the ten contracts that it did not report."

Comments: The Department has been 100 percent in compliance with Fair Employment and Housing requirements for the last two years. We will submit a report on the ten contracts identified as unreported even though the error occurred over two years ago.

- . "Report all consultant contracts to the Legislature, and send an amended report that includes the 15 omitted consultant contracts."

Comments: The amended report requested is currently in the Department's administrative review process.

Mr. Thomas W. Hayes

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October 12, 1988

As mentioned in the report, consultant contracts represent about three percent of this Department's contract processing workload. We are cognizant, therefore, of all aspects of the Public Contract Code and the State Contract Act. While I realize with such a large processing workload my staff may make errors, I want to assure you we will continue to strive to comply with all statutory requirements regarding contracts.

If you have any questions regarding this information, please contact Marie Ashcraft, Deputy Director, Administration, at 445-0260.

Sincerely,

A handwritten signature in cursive script, appearing to read "Kenneth W. Kizer".

for Kenneth W. Kizer, M.D., M.P.H.
Director

THE OFFICE OF THE AUDITOR GENERAL'S COMMENTS
ON THE RESPONSE OF THE DEPARTMENT OF HEALTH SERVICES

We are commenting on the Department of Health Services' response to our audit report to provide clarity and perspective to the department's exceptions to our report. The numbers correspond to numbers we have placed in the department's response.

- ① We believe that our title accurately describes the conditions found at the department.
- ② As we explained on pages 13 and 14 of our report, we reviewed with the contract managers at both departments every contract in our review sample that was not opened to competitive bidding. Furthermore, as we point out on page 14, the Department of General Services' contract managers in charge of reviewing and approving agency requests for exemption from competitive bidding could not establish, from the Department of Health Services' requests, that 19 contracts met the criteria for exemption stated in the State Administrative Manual.
- ③ The report has been changed.
- ④ As we explain on page 27 of the report, the State is exposed to the potential for litigation for work performed by the contractors before the contracts are approved. We believe that this potential exists regardless of whether or not the contractors receive payment for work performed before the approval of a contract. Furthermore, on page 6 of its response, the Department of Health Services concurs with our recommendation that its staff should initiate the processing of contracts early enough to ensure that the contracts are approved before their starting dates.
- ⑤ On page 11 of our report, we point out that the Department of Health Services indicated that the foundation was the only entity capable of performing the requirements for 10 contracts. However, we found that six or more contractors would have bid to obtain one-half of the contracts, and the department could have obtained the three competitive bids required by law, when counting the foundation as a bidder, for 9 out of the 12 contracts.
- ⑥ On page 30 of our report, we conclude that six state employees worked as consultants in violation of the Public Contract Code. This determination was based on a department letter which indicated that five employees were in violation of the code. For a sixth employee, a permanent intermittent, the department was initiating policies to clarify that permanent/intermittent employees are precluded from accepting positions with a contractor funded by the department.



State and Consumer Services Agency

OFFICE OF THE SECRETARY

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Building Standards Commission
Consumer Affairs
Fair Employment & Housing
Fire Marshal
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Museum of Science & Industry
Personnel Board
Public Employees' Retirement System
Teachers' Retirement System
Veterans Affairs

October 12, 1988

Thomas W. Hayes
Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

REPORT P-753 - THE DEPARTMENT OF HEALTH SERVICES DOES NOT COMPLY WITH ALL REQUIREMENTS FOR AWARDING AND MANAGING CONSULTANT CONTRACTS

Dear Mr. Hayes:

Thank you for the opportunity to respond to your report P-753 which addresses recommendations to the Department of Health Services and to the Department of General Services (DGS). Each of the four recommendations addressed to the DGS are discussed in the following paragraphs.

RECOMMENDATION: "To ensure that agencies are complying with the law, the DGS should approve exemptions from competitive bidding requirements for consultant contracts only when state agencies clearly demonstrate that contracts meet the criteria prescribed in the State Administrative Manual. Furthermore, this demonstration should include an extensive survey of all potential vendors for all consultant contracts."

DGS RESPONSE: The DGS would like to emphasize that it does have policies to promote competitive bidding on all contracts. These policies were recently restated to state agencies in Management Memo 88-17, dated July 22, 1988, which provided that exemptions from competitive bidding requirements would only be granted when a complete and documented justification is provided.

As required by the State Administrative Manual Section 1204, a detailed justification was provided to the DGS by the Department of Health Services to exempt the contracts questioned in the report from the requirement of obtaining three competitive bids. These justifications were reviewed against existing standards and procedures and were approved. (1)*

*The Office of the Auditor General's comments on specific points contained in this response appear on page 59.

Thomas W. Hayes

October 12, 1988

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In June 1988, the DGS, as part of its continuing efforts to improve operating procedures, initiated a review of competitive bidding exemption procedures and standards. The use of extensive surveys will be considered as part of this review. If this review identifies weaknesses, improvements will be implemented. In addition, in September, 1988, a subcommittee of the General Services Advisory Council was formed to review contract related matters. We anticipate that proposed changes to the procedures or standards will be presented to this subcommittee of state agency contracting officers for their evaluation and input. Likewise, the issue of contractor evaluations addressed in your other recommendations will also be discussed with this group.

RECOMMENDATIONS: "Enforce the provisions of the code requiring state agencies to submit post evaluations for consultants within 30 days after the completion of the contracts."

"Ensure that state agencies review contractor post evaluations before awarding consultant contracts."

"The DGS should finalize its response to the Office of the Auditor General's recommendations of April 1986 and present its recommendations to the Legislature to improve or eliminate the post-evaluation process."

DGS RESPONSE: The DGS will continue to perform the functions of the Public Contract Code which expressly require action by the Department. This includes the requirement for the receipt, filing, and retrieval of contractor evaluations.

The DGS has expressed its concerns regarding the current post evaluation process and is reviewing those requirements. Recommendations regarding procedures and their implementation for improvement and/or elimination will be presented to the Legislature (in departmental proposal form).

Additionally, the DGS will implement a program of external audits of state agencies beginning in January 1989 which will include a review of state agency compliance with post evaluation requirements.

Thomas W. Hayes
October 12, 1988
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If you need further information or assistance on this issue, you may wish to have your staff contact W. J. Anthony, Director, Department of General Services at 445-3441.

Sincerely,



for SHIRLEY R. CHILTON
Secretary to the Agency

SRC:psf

cc: W. J. Anthony, Director

THE OFFICE OF THE AUDITOR GENERAL'S COMMENTS
ON THE RESPONSE OF THE DEPARTMENT OF GENERAL SERVICES

We are commenting on the Department of General Services' response to our audit report to provide clarity and perspective to the department's exceptions to our report. The number corresponds to a number we have placed in the department's response.

- ① As we explained on pages 15 and 16 of our report, the manager in charge of the reviews of agency requests for exemption from the requirement to obtain three competitive bids stated that "there is no written criteria or policy and procedure for reviewing requests submitted" He further confirmed, in a letter to our office, that the Department of General Services has not used written criteria or policies and procedures for reviewing contracts since he has been the manager in charge of these reviews and that it has had no set policy for seeking justification or information beyond the information submitted on the requests for exemption.

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps